Testimony of Terry L. Brandt, Executive Director of Albina Opportunities Corporation
Before the
US House of Representatives Committee on Small Business, Subcommittee on Finance and Tax
August 4, 2009

Mr. Chairman, my name is Terry Brandt. I am pleased to be here today, and appreciate the invitation to testify before the distinguished House Small Business Subcommittee on Finance and Tax.

Introduction

I am the Executive Director for Albina Opportunities Corporation (AOC), a non-profit lender with a mission to spur entrepreneurship and provide credit to women-, minority-, immigrant- and disabled-owned businesses in low to moderate income communities and CRA qualified areas in the Portland area. AOC desires to make loans to borrowers that have been traditionally under-banked and under-served in our communities.

We have raised our initial capital through local community partners including individuals, foundations, and corporations . These funds are used to make loans to small business entrepreneurs. Our loan sizes range from $10,000 to a maximum of $200,000. We leverage our loan funds by partnering with bank and non-bank lenders on specific loans. We provide the "gap" funding necessary to help mitigate loan risk to our participating lending partners on small business loans. By subordinating our interest in our loan to the interest and loan of a participating bank or other lender, AOC provides more security for the bank and thereby increases the ability of the entrepreneur to obtain needed financing. Initial underwriting and loan servicing is also provided by our partnering bank and non-bank lenders which allows us to keep our overhead expenses low.

We creatively use a variety of alternative forms of loan security, closely monitor the performance of each loan and provide high-level business advisory services to our borrowers to insure they succeed and that our loan is repaid. We are also investigating ways to network through the internet to engage in Peer-to-Peer (P2P) lending opportunities and in August intend to apply to be certified as a Community Development Financial Institution (CDFI). AOC considers CDFI business lending an important tool to restart commercial finance in our community.

Issues

The reason I am testifying today is because events now occurring in the financial marketplace are having a detrimental effect on our ability to make small business loans to qualified businesses to whom we would like to provide capital. We do not make loans without participation by local area banks, thereby leveraging our limited capital to make small business loans.

We have tried to find ways to fund loans in light of recent stricter bank loan underwriting standards. Some level of agreement is needed between AOC and its lending partner to use AOC as a means to provide the gap financing needed to mitigate the bank's perceived risk to make these small business loans. We are unable to make loans to credit worthy small businesses when banks use blanket non-starter underwriting criteria that preclude any discussion at all. In addition, without a partnering bank or non-bank lender, AOC is not able to obtain an SBA guarantee for its qualifying loans.

Traditional bank lending resources have pulled back from the lending marketplace for a number of reasons, including increased borrower scrutiny and stricter loan underwriting criteria.

Recently the Wall Street Journal reported that the White House was searching for ways to help small business by unlocking frozen credit. Shortly thereafter CIT, the largest small business lender in the U.S., fought for its survival. Funds just aren't getting to small businesses. This has had the predictable result of a large increase in applications to AOC for loans from credit worthy small businesses that are being turned away by their regular banks. Other small non-profit community lending partners are also experiencing a similar increased rate of inquiries. The current demand for *qualified* loans far exceeds the supply of lending options available.

AOC wants to continue to provide financing to businesses and to do that, it is important for us to find sources of loan capital and loan guarantees until the banks return to this market. We believe the only source for such capital and guarantees may be the federal government.

My testimony today outlines recommended ways to increase liquidity of community financial institutions so they can continue to lend and keep pace with increasing loan demand.

Background

According to an October 2008 Senior Loan Officer opinion survey issued by the Federal Reserve Board, nearly 75% of lenders say they have tightened their credit standards for approving applications for small business loans. Since the date of this report, credit standards have tightened further. There appears to be a current disconnect between the political will to get banks back into the lending business and the level of increased regulation that stifles lending. Bank examiners are now lowering bank ratings as a result of increased regulation and even suggest that they should not be lending, but saving money for possible increased future reserve requirements. Further, bank discussions indicate that examiners have gone so far as to suggest off the record, that there are really no good loans to make that are worth the risk of making them in this economic climate.

This has caused banks to reorganize their underwriting departments and to increase underwriting requirements to such a degree that no small business loans are occurring. Underwriting changes include:

1. Increased Debt Service Coverage Ratios (DSCR)
2. Stiff collateral requirements
3. Changes in term, rate, fees to accommodate perceived added risk
4. Additional bank statements for all liquid or semi-liquid assets listed on the personal financial statement
5. Minimum credit scores for approval have been raised.

In addition, many banks indicate that it costs them too much to book small loans under $500,000 and they can't make any money from the restricted interest rates and fees allowed by Small Business Administration (SBA) guarantees. All of this is happening while banks also clamp down on other small business funding channels like credit cards, credit lines and non-SBA loans.

Upon being appointed to head the SBA, Karen Gordon Mills stated "*there are over 26 million small businesses in this country and they create 70% of the new jobs. This means that to find our way out of the current economic crisis, we have to find ways to help small businesses stay in operation and even expand.*" In addition, it is estimated that over 50% of the national GDP is driven by small business. In Oregon, there are more than 90,000 small business employers representing almost 98% of the state's employers and nearly 60% of its private sector workforce. Obviously, maintaining the health and vitality of small business is critical to the overall health of our economy.

What happens to small business lending when banks collectively contract and traditional financing routes dry up? Lenders that adopt all or nothing restrictions and responses to problems do not consider the bulk of loans that can be effectively underwritten. Their over-response to perceived problems results in stifling the growth of good small businesses. Lender under-performance and lack of creativity will not solve the lending log jam.

With the exception of the Micro-Loan Program, almost all the lending in the SBA's tool kit is done by banks. When confronted with current financial complexities, small businesses can't get loans, not because their ventures are considered too risky, but because the capital markets themselves are in crisis. And the SBA's programs are too dependent on banks and a few non-bank lenders to provide much help. If, for some reason, these lenders simply cannot or will not lend money to small businesses, the predominant SBA 7(a) loan guarantee program will be significantly underutilized.

AOC has been challenged to find ways to establish partnerships with SBA approved bank lenders given many of the reasons previously stated. As an example of a recent response to this challenge, AOC has offered to mitigate the perceived risk in a prospective loan by agreeing to fully subordinate its portion of its SBA loan guarantee to its lending partner. In other words, for an approved SBA guaranteed loan, AOC would be willing to allow its bank partner to receive up to 100% of the SBA guaranteed portion of a qualified small business loan as security for its level of participation. By financing only the guaranteed portions of AOC's loans, a bank would receive in essence a 100% guarantee from the SBA on any of its loans. At this time, AOC has yet to find a bank or non-bank lender willing to partner on this loan. In addition, without a bank partner, AOC's ability to obtain a loan guarantee is restricted unless it could also be approved as a non-bank lender by the SBA. As an approved SBA non-bank lender, AOC could directly enhance its loan security and provide more stability to its current community of investment partners.

To make matters more troublesome, non-bank lenders have also pulled back due, in large part, to a lack of access to capital and perceived credit risk. Soon after becoming Treasury Secretary, Timothy Geithner observed that before the credit crisis more than half of all small-business lending was funded through the shadow-banking system of non-bank lenders--not through insured deposits. The so-called shadow banking system for small business includes commercial finance companies, leasing companies, credit unions, credit card companies, receivable factors, economic development programs and even life insurance firms. .

The SBA does have a handful of non-bank financial institutions among its approved lenders. Non-bank lenders are not subject to the same regulations as banks covering things like underwriting standards and portfolio management, and sometimes their business models can generate other problems. The SBA has recently published a new set of lender oversight regulations that may help to address some of those problems. However, one hopes the regulations are effective without being sufficiently burdensome to drive these non-bank lenders away from the SBA altogether. They provide an important safety net for situations in which banks are unavailable to small businesses.

Moving Forward

AOC's small business lending problem may be considered not too dissimilar to the SBA's dependence on bank and non-bank lenders to administer its loan guarantee program. Both organizations are dependent on its lending partners. In order to provide debt financing for AOC's qualified borrowers it is necessary to find a stable source of lending capital. Until banks return to this market, we will be unable to satisfy the demand for loans needed by our local small businesses.

SBA programs are required to serve only borrowers unable to secure loans from another source. AOC's increasing numbers of inquiries can certainly satisfy this requirement. SBA loans can also be offered with longer terms than conventional loans, allowing borrowers, who commonly lack sufficient net operating income (NOI), to meet DSCR requirements. AOC is receiving loan requests from long running small businesses that are experiencing temporary drops in their NOI due to the ripple effects of the historic downturn in the world economy. They need oxygen to survive and will once again thrive if given some financial breathing room.

Recommendations

Utilize the Troubled Asset Relief Program (TARP) to Enhance Lending through banks or through organizations like AOC

TARP is not going to quickly or meaningfully stimulate the small-business sector, and the economy isn't going to recover until small businesses begin to expand again. TARP isn't stimulating small-business lending. Most TARP money was given to banks, which in turn didn't provide most of the money for small-business lending. Many banks used TARP funds to repair their balance sheets rather than extend new credit.

There is a need for TARP funds to increase liquidity to enable community financial institutions to build lending capacity to meet increasing loan demand and fill financing gaps resulting from banks' retrenchment. Access to

Treasury-rate financing for businesses is critical and could be responsibly implemented through proven delivery systems of community financial institutions by ear-marking some TARP funds for small business loans either through banks or community financial institutions like AOC. However, as reliance on banks to insure the trickle down of TARP funds to small businesses is not now working: perhaps some TARP funds could be ear-marked for community financial institutions to loan to small businesses.

Section 103 of the TARP legislation states, in exercising the authorities granted in this Act, the Secretary shall take into consideration - *ensuring that all financial institutions are eligible to participate in the program, without discrimination based on size, geography, form of organization, or the size, type, and number of assets eligible for purchase under this Act.* We believe that investments in organizations like ours are consistent with the purposes of the TARP legislation.

Utilize the SBA Non-Bank Lending licensing capability to enhance the opportunity for small businesses to gain access to SBA loan guarantees

The last non-bank lender to receive a new "Section 7A" license was during the Reagan Administration. The SBA should be encouraged to license non-bank lenders, and to update and modernize the 7A program. In the past, SBA programs have been unfortunately cut back year-after-year and are now almost totally dependent upon banks. The SBA lending industry is a shadow of what it could be.

AOC and similar community based lending organizations need access to capital to make loans. If approved as a new licensed SBA guaranteed loan lending organization, AOC would be able to structure and price its own participations with its lending partners whether they be bank or non-bank. This would expand its ability to attract additional capital from a variety of sources including the growing P2P lending markets. A review of SBA programs with an eye towards inclusive lender eligibility, including non-bank participants, could renew the SBA and add capital to the market.

Thank you for your consideration of these recommendations. I would be happy to answer any questions that you might have for me. Again, I appreciate the opportunity to testify here today on such an important topic.

Terry L. Brandt
Executive Director
Albina Opportunities Corporation
430 NW 10th Avenue, Suite 101
Portland, OR 97209
Phone: (503) 288-7292
Fax: (503) 282-4691
Email: tbrandt@albinaopportunities.org